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Business in Brief

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THE CHASE MANHATTAN BANK

The business recession is approaching its critical stage. If it is to prove moderate, as was the case in 1949 and 1953-54, some seasonal pick-up in the spring is to be expected. That would signify at least a temporary bottoming out of the decline in business.

Such a leveling could bolster confidence while further adjustments are worked out. The apparent speed of the decline—a drop of 10% in industrial production in six months—has generated apprehensions. The idea that a major post-war downturn is inevitable still colors the thinking of many observers. This thinking has led to a slowdown in purchases of durable goods by both individuals and industry.

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A leveling in activity could bring into play what has been termed the principle of "favorable disappointment". If an expected widespread and severe deterioration in production and employment does not materialize, then those who expected it are "favorably disappointed". Their reaction may be to resume buying. Experience in 1949 and 1953-54 followed this general pattern.

So far, at least, the recession fits the pattern of previous moderate recessions, rather than that of more severe adjustments. A 10% drop in industrial production in six months is well in line with experience in 1949 and 1953-54, as well as that in earlier moderate recessions.

Actually, the statistics on industrial production exaggerate the extent of the decline. Total national output has fallen by less than 3%. Over-all employment is less than 2% below a year ago. Personal income is only 1% below the peak reached last August.

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It is possible that we may see an end to the decline before long. This does not mean that an upturn is imminent—experience shows that it takes time to work through a recession. But there are a number of signs that the decline is moderating.

¶ **Inventory liquidation** reached a rate of more than $8 billion a year in January. That rate cannot be sustained for many months if final sales remain at approximately their recent levels.

¶ **New orders** in the key field of industrial machinery moved up a bit in December and January.

¶ **Government expenditures** are increasing.

¶ **Consumer spending** has held up relatively well. This is true despite the lag in new auto sales (9% of total retail sales last year) and department store sales (6% of the total).

These forces could operate to check the decline in over-all production and employment. A reduction in the rate of inventory liquidation would add several billion dollars to the rate of orders and production. Meanwhile, rising government expenditures, combined with continued basic underlying strength in consumer markets, could help sustain over-all demand.

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A leveling off would not necessarily mean an immediate end to the recession. Further adjustments in investment, inventories and autos appear to lie ahead.

On the investment front, the recent SEC-Commerce Survey showed that businessmen plan to invest 13% less in new plant and equipment this year than last. That's a reduction of almost $5 billion. These Surveys have established a credible record in the past decade—actual results have generally been within 2% of the expenditure figure elicited by the Survey.

Machinery production has already declined 14% from the average 1957 level. Yet the SEC-Commerce Survey, plus the sag in exports points to some further adjustment. Auto assemblies are off 29% from a year ago and stocks are high. If sales continue to lag in the spring, some further cuts in output may be indicated.

The process of absorbing these adjustments could run on for some time. The problem then would be one of generating the forces that might lead to an upturn in activity sometime in the second half of the year.

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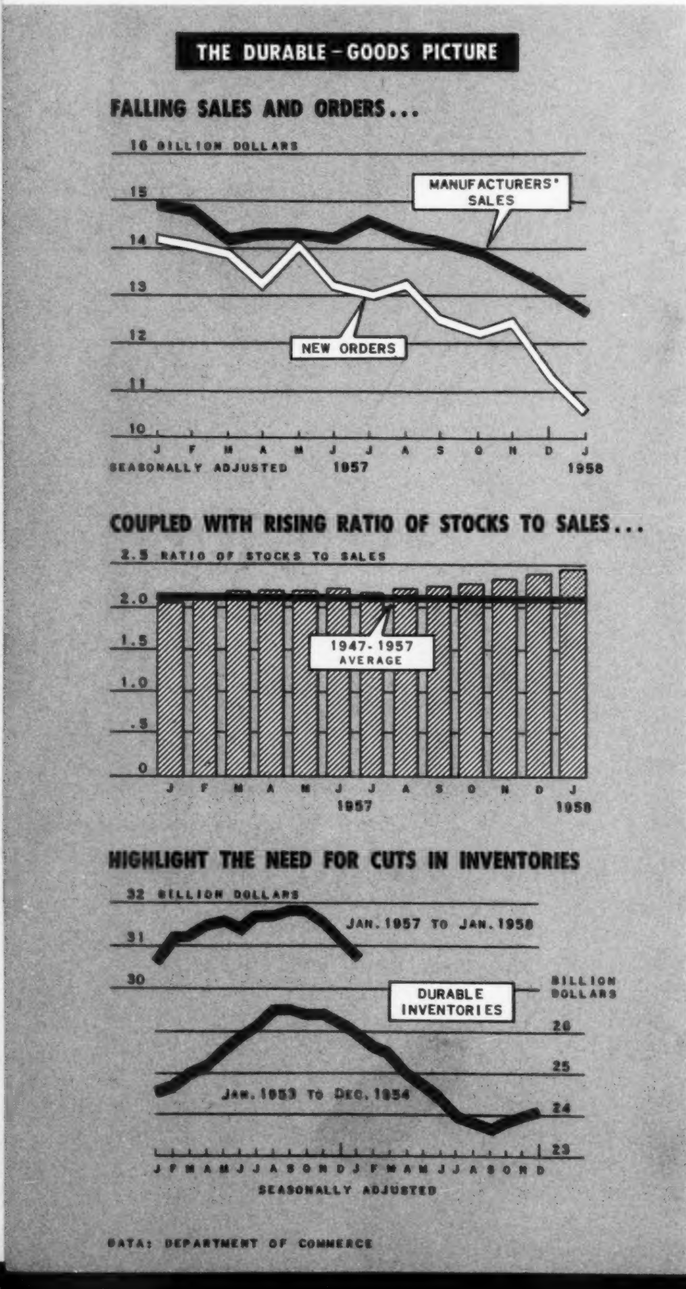
Will the normal operations of the economy produce an upturn? Or is a tax cut needed? These questions will receive much attention in the period ahead. At this juncture, the appropriate course would be to await the result of other anti-recession policies. With defense expenditures increasing, it would be the better part of wisdom to consider tax relief as a last resort in dealing with the current downturn. Hasty action in cutting taxes and increasing civilian expenditures could complicate the task of avoiding inflation when the business curve turns up again.

INVENTORIES

It is safe to say that inventories are always in a state of flux—and the sharp and sudden swing to liquidation during the past few months tends to highlight the importance of these movements to our economy.

Throughout the entire postwar period the alternate rise and fall of inventories—accompanied by increased and decreased output and employment—has played a key role in over-all patterns of business activity. Why is this sector so volatile? How can the same volume of inventories be "enough" at one time and "excessive" a short while later?

In a very real sense, no one wants to hold inventories—they're held only to be disposed of. Through the various stages of the productive process, raw materials become transformed into finished goods and ultimately pass into the hands of final consumers. At each stage, manufacturers, wholesalers and retailers hold inventories to meet their current and anticipated needs. These stocks of goods help to insure smooth production, wide selection and prompt delivery.



As goods are sold, businessmen reorder to replenish their stocks. And it is this very process of ordering and reordering which contributes so greatly to the volatility of inventory swings.

How Orders Pyramid

Suppose a retailer seeks to keep on hand one and a half times as many goods as he sells in a month (inventory-sales ratio of 1.50). Then, in times of rising sales his inventories will increase at a more rapid pace. For example: if monthly sales rose from $10,000 to $20,000 he would increase his inventories from $15,000 to $30,000. His orders to wholesalers would increase not by $10,000 but by $15,000.

Let us assume that the wholesaler likewise tries to maintain an inventory-sales ratio of 1.50. As a result, his orders to manufacturers would rise by $22,500 ($15,000 × 1.50). Thus, a $10,000 increase in consumption snowballs—"accelerates"—into a more than double rise in production.

But this principle holds equally true on the downturn. A decrease in consumption of $10,000 would be magnified, under the same conditions, into a $22,500 decline in production.

And, in addition, a swing in inventory policies has what are termed "multiplier effects." This means that cutbacks in production forced by the inventory adjustment lead to lay-offs and lower incomes in the areas immediately affected. The people who are laid off, or forced to work shorter hours, or who receive lower dividends usually reduce their expenditures to some degree. Thus, the reduction in production typically exceeds that directly attributable to the inventory factor.

Recent Trends

Given these circumstances, the events of the past few years take on added meaning. Rebounding from a series of reductions during the recession of 1953-54, inventories mounted steadily for the next two and a half years. Month after month the figures soared, until by September of last year inventories had passed the $91 billion mark—an astonishing $15 billion over the starting point.

To be sure, rising prices tended to inflate these book value measures. Even so, the increase in the physical volume of goods in stock approached $10 billion. This represented the greatest sustained growth in our entire peacetime history.

But, if the upward trend in overall inventories was

fairly smooth, the shifts among sectors were uneven.

• Manufacturing led the way, accounting for fully two-thirds of the rise in stocks. Most of this increase was in durable goods.

• Wholesalers and retailers proceeded more cautiously. Retailers, especially, were generally conservative in their inventory policies; to the extent that their inventory-sales ratios (commonly used in evaluating levels of inventories) were low by postwar standards during all of 1957.

Clearly, inventories are not accumulated in an economic vacuum. Rising sales provided the incentive during much of this period; but for manufacturing, in particular, stocks rose far more rapidly than sales as anticipations exceeded results. Consequently, by late 1957 inventories by almost any standards were excessive in most durable lines, and when the hoped-for Fall pickup in business did not materialize, sentiments faded and aggressive liquidation ensued.

So far, the major cuts in inventories have centered in the manufacturing sector, and the impacts on production and new orders have been direct and dramatic. The swing from adding to inventories in the third quarter of 1957 to cutting them in the fourth, and extending these cuts into early 1958, has reduced demand for goods by an $8-10 billion rate. That's enough to directly account for a decline of about 5% in the index of industrial production, or almost half the current drop.

And if we further include the multiplier effects of these cutbacks, the full impact turns out to be far greater.

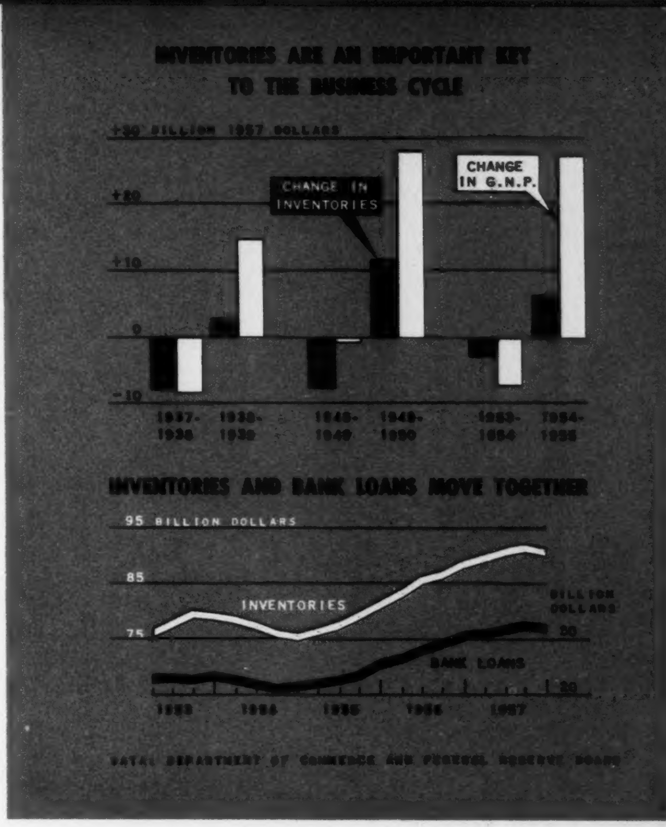
Inventories and Business Cycles

Nor has it been only during the current recession that the importance of inventories has been highlighted. In fact, shifts from adding to inventories to reducing them have played a major role in most past business downturns. Thus, studies of the National Bureau of Economic Research show that:

• Increases in business inventories have accounted for about one-fifth of the total rise in production in nine periods of expansion since 1918;

• And inventory liquidation, on the average, accounted for more than half the decline in output in periods of business contraction since 1918.

More recently, the patterns of recession seem to have centered increasingly around inventories. Liquidations accounted for virtually all of the 1949 downturn and almost half of that in 1953-54. This is not to say that postwar cycles are exclusively a function of inventory changes. In each case shifts in other sectors of the economy either triggered or contributed to the declines in business activity and this is particularly true today. Nevertheless, swings in inventories were of paramount importance in every instance.



The Outlook

But the major question remains: just how long can these inventory liquidations continue? In this, the past record is of only limited assistance. In 1949 and 1953-54 liquidations continued for about a year in each case. Yet the declines were not steady: the patterns indicated a sharp voluntary decline at first, and tapering off with a period of *involuntary* liquidation at the end of the cycle—as resurging demand emptied shelves.

In the current recession, however, the picture seems to be somewhat different. Stocks are being worked off at a much faster rate—particularly at the manufacturers' level. To be sure, hard goods in general appear vulnerable to further declines; but major reductions have already been effected in several lines and there are indications that many firms are operating on a hand-to-mouth basis. In addition, retail trade inventories seem to be in a generally conservative position.

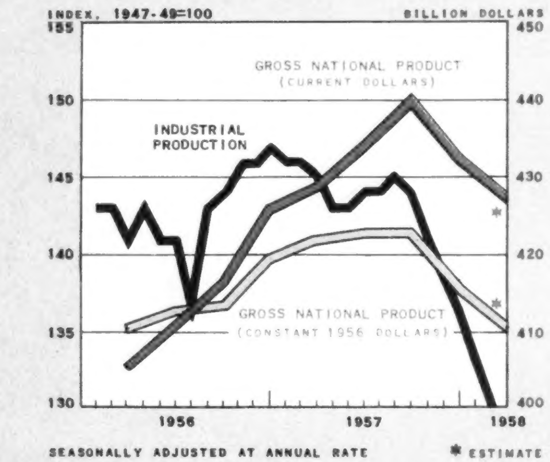
On balance, it seems probable that a good deal of the impact of the inventory shift already has been absorbed. Short of a further major deterioration of business conditions, it is difficult to see how inventory liquidation could continue at current rates much beyond mid-year. And it is the *rate* of decline that is paramount, for if inventories drop by $600 million in one month and by only $400 million the following month, output would have to rise by $200 million to maintain the same flow of goods.

Consequently, if final demand continues to hold up fairly well, a slowdown in inventory liquidation could provide an important fillip to business later this year.

RECENT BUS

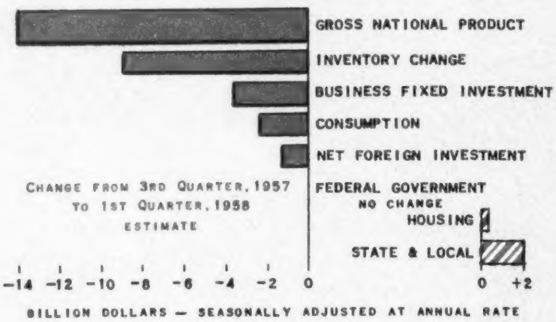
Continuing Adjustments in Business Activity

INDUSTRIAL PRODUCTION AND GROSS NATIONAL PRODUCT



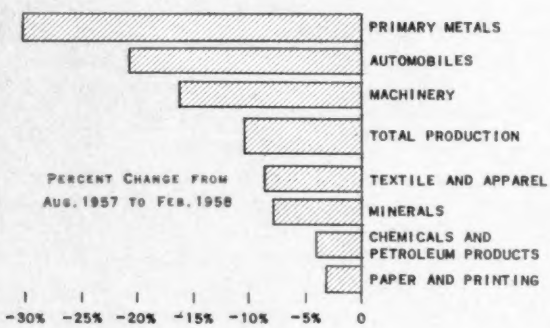
So far the major impact of the recession has been in the industrial area, and more specifically in durable goods production. Thus, industrial production is down 10% since last August, while the broader measure of gross national product has declined less than 3%.

MAJOR ECONOMIC TRENDS



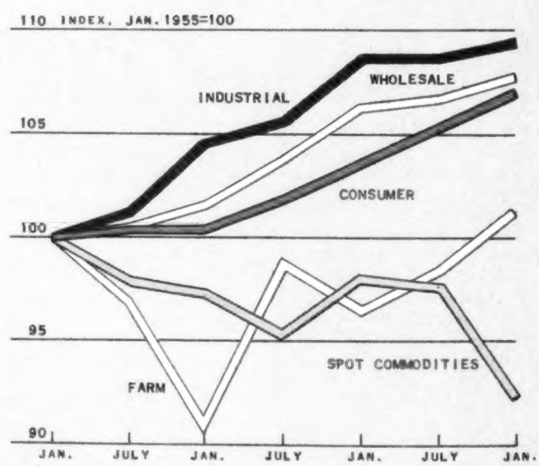
An abrupt shift in inventory policies triggered the decline. These cuts have accounted for the lion's share of the downturn. In addition, exports and consumer spending have backed off slightly from record levels. Capital investment may decline throughout 1958. Rising state and local outlays have been a partial offset thus far.

PRODUCTION TRENDS



Steel and other primary metals have been hit hard by the inventory cuts and by the decline in demand for durables. Nondurables, on the other hand, appear to be holding up better.

PRICES

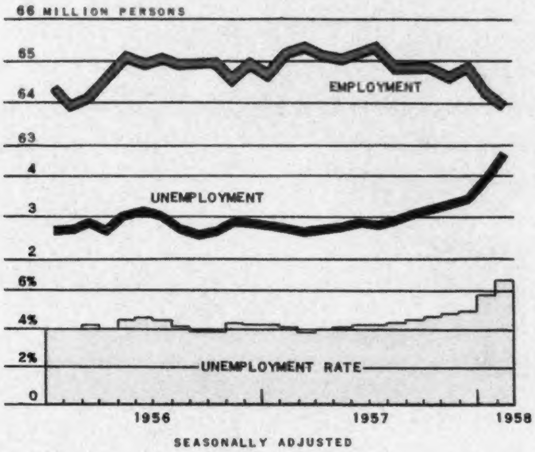


As in past recessions, the downturn in consumer and wholesale prices has lagged behind that in general business. However, the sensitive commodity index has moved down.

SINESS TRENDS

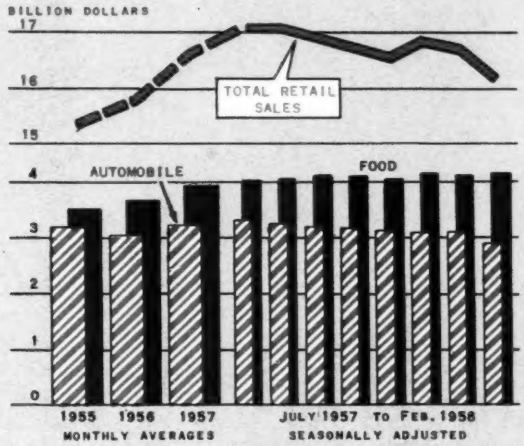
y Highlight the Vital Role of the Consumer

EMPLOYMENT AND UNEMPLOYMENT



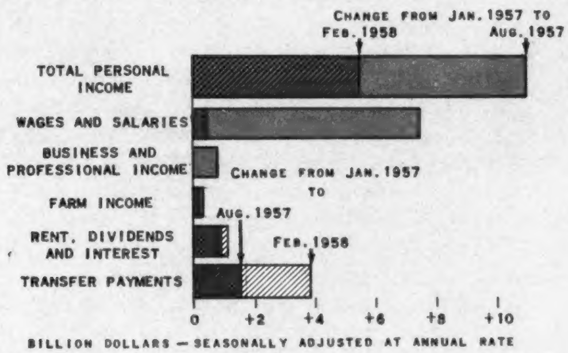
Unemployment has increased steadily since last August, with particularly steep increases occurring in January and February. However, while unemployment has risen by 2 million in the last year, employment is off less than 1.3 million—and 80% of this drop has been centered in durables manufacturing.

RETAIL SALES



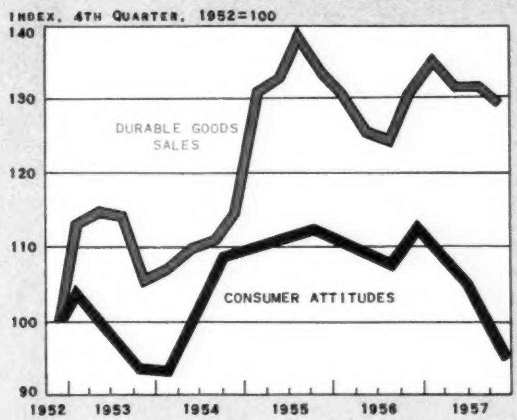
Retail sales held up well during Christmas, but have fallen off since then. The current figures are slightly behind those of a year ago and reflect, importantly, the decline in auto sales.

PERSONAL INCOME



Personal income has dropped by somewhat over 1% since last August. Wage and salary cuts have accounted for an amount in excess of the decline, but rising transfer payments—for unemployment compensation and other social security benefits—have cushioned the drop.

CONSUMER ATTITUDES



Consumer psychology is dominated by concern about the recession. The index of confidence dropped a bit more sharply late last year than in 1953-54, yet was still slightly above the low reached then.

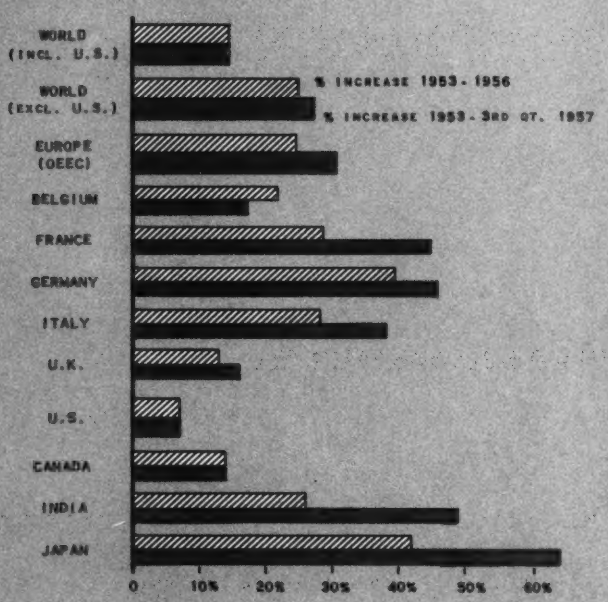
WORLD ECONOMIC GROWTH

Economic growth in the free world has been rapid in recent years. Measured in terms of industrial production many countries have moved ahead faster than the U. S. This growth has been important to the U. S. directly in stimulating exports, and indirectly in promoting a stronger free world economy.

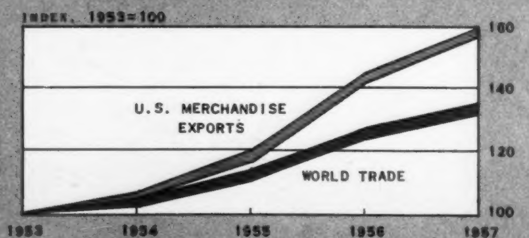
The U. S. and Canada showed their greatest growth from the beginning of World War II until around 1953. Since then, while there has continued to be considerable expansion, the pace has slowed. On the other hand many countries suffered a serious set-back during the War and only caught up to pre-war levels toward the end of the 1940's. Since 1953 industrial output in many of these countries has increased at a dramatic rate.

But the increase has not been even. In some nations industrial production advanced at a particularly fast rate during the three year period 1953-56: Japan, 42%; West Germany, 39%; Austria, 38% and Greece, 34%. Other countries advanced more slowly: Canada, 14%; the U. K., 13%; Denmark, 11% and Chile, 4%.

PRODUCTION GAINS IN THE FREE WORLD...



REFLECT INCREASED FOREIGN TRADE



DATA: ECONOMIC REPORT OF THE PRESIDENT, 1958

In some cases, such as India, the high growth rate was due to strong government support of an industrial program, starting from a relatively small industrial base. In other cases, such as Germany and Japan, it was due to a tremendous economic vitality in an already highly industrialized economy.

Effects of U. S. Recession

Now the U. S. is in a recession, and many countries seem to be leveling off. Europe, which had achieved an average annual growth rate of 8% between 1953 and 1956, experienced an increase of less than one per cent in the first three quarters of 1957. The U. S. meanwhile had a 4% drop in industrial output.

The tapering off in the economies abroad has not been induced by foreign trade relations. It seems rather to be a normal readjustment which usually follows a sustained period of rapid growth. Moreover, the leveling off has not been abrupt, nor are there signs that it will develop into a severe downturn.

Trend of U. S. Exports

However, it has had an effect on U. S. exports. While the investment boom was in full swing abroad, the demand for capital goods and raw materials grew at a more rapid rate than the supply in the rest of the world. The U. S., long a major exporter of these items, increased its exports to fill the gap. As the investment boom rounded out, so also did the demand for these goods, and the third quarter of 1957 witnessed a fairly sharp drop in U. S. sales abroad, with a slight seasonal pick up in the fourth quarter.

Most predictions of U. S. exports indicate an 8% to 10% decline in 1958. But even this would leave a large volume of trade—around $17 billion in merchandise exports alone.

When Will Growth Resume?

This raises the question of when world industrial production will resume its upward march. This, of course, depends in part on what happens in the U. S. If the present recession is moderate and short-lived then its effects should be minor. Thus, the 1953-54 recession in the U. S. did not have serious repercussions on other countries.

This experience should have laid to rest the idea that any faltering in the rate of growth in the U. S. was bound to unsettle the economy of the entire free world.

No one can confidently prophesy the course of the world economy as so many varying forces have to be taken into account. However, the vitality of both industrial production and world trade in recent years would appear to provide support for a generally optimistic view of the ability of the free world economy to cope with the economic problems that appear to lie ahead.

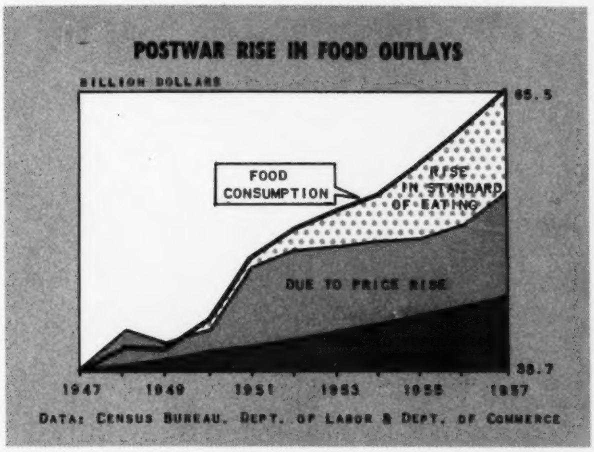
TRENDS IN FOOD CONSUMPTION

"The desire of food is limited . . . by the narrow capacity of the human stomach."

Adam Smith may have been quite right when he set down these words almost two hundred years ago. Today, the average American consumes roughly 1,500 pounds of food a year—about the same rate as in 1910. But the similarity in totals conceals a host of developments which have combined to make the food industry one of our most dynamic—and least appreciated.

Spending Stays High

Some of this lack of appreciation probably rests on the shoulders of another economist, Christian Engel, who set forth a series of propositions in the mid-nineteenth century which were widely accepted. As incomes rose, he stated expenditures for food would also rise, but the *percentage* of total income spent for food would fall.



Engel explained this observation in terms of food's function as a necessity: with low incomes people would devote a considerable proportion of their budgets to food to meet their subsistence needs. But as incomes rose, food requirements would hold fairly steady (Adam Smith's "stomach," again), with surplus funds being applied to services, durable goods and savings. How well has this principle applied to our economy?

Essentially, it has not proved out. Since the end of World War II expenditures for food have constituted a larger share of consumer budgets—in spite of rapidly rising incomes—than was the case in earlier years.

- For one thing, there are more mouths to feed—population is up 19% since 1947. Record baby food sales reflect this surge.

- In addition, food prices have mounted by 20% during that time, putting a crimp in the consumer's pocketbook.

- Even so, total outlays for food soared almost 70% since then. As a result, all this adds up to a 18% increase in the average "standard of eating."

The overall figures are impressive, too. Since 1947 annual expenditures for food in the U. S. rose by $27 billion. That's more than the *combined* increases in spending for automobiles, housing and other durables during this period. In addition, current food outlays are running at a rate in excess of $65 billion a year—very close to one-fourth of total consumer spending.

No other industry even closely approximates it in size.

Proteins and Processed Foods

Clearly, a good share of the expanded food expenditures simply represent an upgrading of diets. Consumption of meats and other high-protein items has risen fairly steadily, while grains and potatoes—the carbohydrates—have fallen considerably.

But of even greater significance has been the tremendous growth of foods with built-in services. Today's housewife can avail herself of a whole range of timesavers in the preparation of meals. Packaged goods, instant foods, prepared mixes, pre-cut meats, frozen foods and dinners—all have grown in importance in recent years.

What has this meant to the average housewife? In the early 'twenties she generally spent five to six hours a day in preparing meals; today it's less than half of that. What's more, the development of these processed foods has resulted in a sharp rise in sales of traditional kitchen appliances, plus the introduction of dozens of other household conveniences. Apparently, there seems to be no Engel's Law for leisure.

And this is an important point—for the fact that the food industry has displayed such vitality in recent years should serve to highlight the importance of change and adaptability in the marketplace. Too often, in generalizing about future industrial trends, observers tend to gloss over these very forces making for progress.

Growth is never inevitable; but neither is decline. The sustained success of the food sector in offsetting downward forces clearly bears this out.